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SUBJECT: TAIWAN SEMICONDUCTOR FIRMS - FOCUSED ON CHINA

REF: A. TAIPEI 000025

- [1](#)B. TAIPEI 1481
- [1](#)C. TAIPEI 2919
- [1](#)D. TAIPEI 3926
- [1](#)E. TAIPEI 4164

Classified By: Daniel K. Moore, Chief of Economic Section at AIT for reasons: 1.4 (b) and (d)

[1](#)1. (SBU) Summary: Semiconductor industry executives described Taiwan's decision to permit investment in more advanced manufacturing technology in China as a small step in the right direction. They do not expect to see further liberalization of investment restrictions during the Chen administration. They also dismissed the impact of China's local government subsidies and value-added tax policies on their strategy for competing in the Mainland market. Taiwan firms also expressed little interest in diversifying their investment to India. End summary.

0.18-micron Approval) Small Step in the Right Direction

[1](#)2. (C) During a meeting with United Microelectronics Corporation (UMC) Vice President of Corporate Marketing Lee Chung on 17 January, Mr. Chung told AIT that he considered 0.18-micron to be a bicycle technology,⁸ but that Taipei's approval was a step in the right direction because it would bring Taiwan firms that much closer to the China market. Chung believes that China's semiconductor industry is about two years behind Taiwan's technologically. He commented that while it is difficult to develop advanced technology, it is even more difficult to keep it a secret forever. Eventually, firms will figure out how to develop the technology from vendors or from new employees. Sean Kao, an industry consultant with the Market Intelligence Center (MIC), said the impact of the new policy on the PRC's semiconductor industry would be minimal because 0.18-micron is already widespread there.

Further Liberalization Not Likely This Administration

[1](#)3. (C) When asked how quickly he thought Taipei would move to further ease technology restrictions on semiconductor investment in the mainland, UMC's Chung remarked, "Not this

government, hopefully in 2008,8 and expressed his private view that direct transportation links would also be implemented under a Kuomintang (KMT) government. Taiwan Semiconductor Manufacturing Company (TSMC) Public Relations Department Principal Specialist Michael Kramer, likewise, did not view the approval of 0.18-micron technology as a sign that the Chen administration would move forward quickly with more semiconductor liberalization. Roger Liao, Deputy Director of the Taiwan Electrical and Electronic Manufacturers, Association (TEEMA), also told us that he did not believe that Taiwan,s restrictions on China-bound investments would change further under the DPP, but might change under a KMT government; only time would tell.

Easing Restrictions - Chen Makes Final Call

14. (C) MIC's Kao told us that the decision to relax technology restrictions went all the way up to President Chen. Of the ministries involved, Kao said the Ministry of Economic Affairs (MOEA) appears to be more supportive of the industry position in favor of further opening. The Mainland Affairs Council (MAC) and the Ministry of Foreign Affairs (MOF), on the other hand, are more conservative. TSMC's Kramer echoed Kao's assessment of the approval process and noted that his firm had primarily used MOEA as a channel in lobbying the government for further easing of restrictions. Taiwan Semiconductor Industry Association (TSIA) President T.Y. Wu also targets MOEA in its lobbying efforts, but the association also works with other agencies, including the National Science Council and Ministry of Finance.

15. (C) Deputy Director David Hsu of MOEA,s Semiconductor Industry Promotion Office (SIPO) told us that the decision to

TAIPEI 00000998 002 OF 003

lift technology restrictions reaches Chen,s level because the issue is so politicized. MOEA Industrial Development Bureau (IDB) Deputy Director Ming-Ji Wu noted that the Taiwan authorities face considerable political pressure to lift restrictions on technology transfers to Mainland China and said he personally hoped the United States would slow down technology transfer approvals for US firms to relieve that pressure. TSIA's Wu and TSMC's Kramer also expressed the view that pressure from European and American firms, especially semiconductor equipment makers, had been a factor in Taiwan's decision to remove the ban on investment in 0.18-micron technology.

China's Subsidies for SMIC - Not a Big Concern

16. (C) Local Chinese governments are funding the construction and equipping of two new fabs in Wuhan and Chengdu, to be managed by leading China-based semiconductor firm SMIC. UMC's Chung told us he was not concerned about the subsidies because &SMIC,s customers are few and they are using older technology.8 Although UMC still considers SMIC a &serious price interrupter,8 Chung believes that competition from SMIC has decreased in the past two years due to the loss of key SMIC executives. TSMC's Kramer expressed his view that &China is still a developing market and SMIC still gets only a small amount of business.8 MOEA/IDB's Wu said the subsidies put pressure on Taiwan, but indicated the Taiwan authorities have no plan to counter with subsidies of its own. Instead, Taiwan will continue to use tax incentives, he said.

China,s Elimination of VAT Rebates Trivial

17. (C) Taiwan semiconductor executives agreed that the PRC's VAT rebate for domestically produced chips and its subsequent elimination in 2005 had little influence on the decision of Taiwan firms whether to establish operations in China. According to UMC's Chung being close to the PRC market and

talent pool are the key drivers of UMC's presence in China (through its affiliation with He Jian, a PRC semiconductor foundry). TSMC's Kramer pointed out that the process of applying for and collecting the rebates was tedious and time-consuming. He emphasized that TSMC set up operations in China for strategic reasons) because of its promising market. TSMC hopes to be able to supply 0.18-micron chipsets for China's long-anticipated, homegrown third-generation (3G) mobile communications standard, TD-SCDMA.

Little Interest in Investment in India

¶18. (C) Despite a new incentive package for semiconductor manufacturing passed by the Indian government in early January, Taiwan executives expressed little interest in investing there. TEEMA's Liao, who had just returned from India, acknowledges the potential for growth of high-tech industries there, but believes India still has a ways to go in the area of chip manufacturing. Liao argued that it made no sense for India to focus on manufacturing when its strength was in design. UMC's Chung said his firm has no plans to build fabs in India because of infrastructure problems and cultural differences. Aside from expanding its capacity in Singapore and Tainan, UMC currently does not plan to expand elsewhere with new fabs. Taiwan is still considered the most cost effective place for chip manufacturing and possesses a good talent pool, according to TSMC's Kramer. TSMC does not have plans to build fabs in

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India but is considering opening a sales and marketing office there.

¶19. (C) TSIA's Wu, who visited India in 2006, felt that India is not ready for chip manufacturing because it lacks the proper infrastructure, but he speculated that its design and packaging capabilities would probably strengthen. Taiwan semiconductor manufacturing firms, according to Wu, do not want to be the guinea pigs in efforts to develop the industry in India. TSIA members have also explored Singapore, Vietnam and Malaysia as options for chip

TAIPEI 00000998 003 OF 003

production, but the cost structure in Singapore and Malaysia is high, and Vietnam lacks the necessary skills and infrastructure, Wu said. MIC's Kao told us the Taiwan authorities actively encourage Taiwan firms to go to India * even though its production costs are no lower than China's * because it's not China.

Comment) Focused on China

¶10. (SBU) Access to China's market is a key objective for Taiwan firms, and the ability to fabricate more advanced chips helps them stay competitive there. Taiwan's semiconductor firms will keep pushing hard for liberalization of more advanced technologies. China will continue to be the focus of their overseas expansion efforts, regardless of efforts to direct investment elsewhere. End Comment.

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